Matakuliah : Manajemen Pemasaran  
Dosen : Dr. Heni Iswati, SE., MM.  
Tanggal Ujian : 13 Desember 2014  
Waktu : Sepekan, Dikumpul Selambatnya 20 Desember 2014 Pkl. 12:00 wib  
Sifat Ujian : Take home  

Perhatian :  
1. Simaklah seluruh soal dengan baik, kemudian jawablah dengan: argumentatif, logis, analitik dan sistemik!  
2. Lembar soal harus dikembalikan bersama dengan lembar jawaban!  
3. Sifat ujian Take Home.  
4. Tulis Nama, NIM dan No. Absensi pada lembar soal dan lembar jawaban!  
5. Apabila dalam jawabannya terindikasi, “Seratus persen sama” diantara peserta ujian, maka akan mempengaruhi nilai  

Soal :  

1. Buat dan Jelaskan Analisis Strategi Pemasaran terkait dengan naskah "Sony Playstation 3: Game Over?” di bawah ini!

<table>
<thead>
<tr>
<th>Materi Soal</th>
<th>Ketua Program Studi</th>
<th>Dosen Pengampu</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dr. Setyani Dwi Lestari, ME</td>
<td>Dr. Heni Iswati, SE., MM.</td>
</tr>
</tbody>
</table>
Sony PlayStation 3: Game Over?

[When you look at the history of the video game industry since the PlayStation was launched back in 1995, we were able to take the leadership position very quickly with the PlayStation. With PlayStation 2 we have more than 110 million gamers and consumers enjoying the PlayStation 2 on a worldwide basis. And I think we have a very loyal following for the PlayStation family of products. So with the PlayStation 3, I believe that we are going to be able to quickly take the leadership position once again and maintain that position for a very long time.

— Kaz Hirai, President and CEO, Sony Computer Entertainment of America, November 17 20061

It was a picture that was reminiscent of the launch of the original PlayStation nearly a dozen years before. Some eager customers had arrived as early as 6am and from as far as New Jersey to a video game store in Manhattan with the hope of purchasing one of the newest and most sought after video game consoles. By 9am, the number of customers waiting for entrance to the store exceeded 100 and the line extended down the block. One customer in line had been searching stores across the region for two weeks in order to find a console for her brother’s twenty-fifth birthday. A twelve-year-old and his grandmother were visiting their third store in search of the new console. “I just hate what you have to do just to get one,” the boy said.2

In one sense, long lines and sold-out stores were typical at the beginning of each new generation of video game consoles. What made the scene outside of the video game store in Manhattan quite surprising, though, was that the hopeful customers were not waiting in order to purchase a new PlayStation 3 (PS3) game console from Sony, the undisputed market leader from the previous two generations of video game consoles. Rather, these particular customers were waiting in line to enter Nintendo’s flagship store, and it was the Nintendo Wii that they were after.

A second surprising aspect of the scene in Manhattan was that it was by no means an isolated event and, perhaps most surprisingly of all, was occurring a full seven months after the launch of the Wii in the United States. A spokesperson from Toys R Us, Kathleen Waugh, said that its stores around the country continued to receive regular shipments of the Wii but would typically sell out immediately after each shipment was received due to demand. And according to industry analyst

1 Interview on Squawk Box, CNBC, November 17, 2006.

Chris Byrne, “the PlayStation 1 was certainly a big introduction, but I don’t recall any game system more than six months after its launch still having this kind of demand.”

The early success of the Wii appeared to put Sony in a precarious position. Sony had invested heavily in the development of the PS3 and by almost every account it was the most technologically advanced video game console of the seventh generation, which included the Wii, PS3, and Microsoft’s Xbox 360. In particular, the PS3 was powered by the Cell Broadband Engine, a new type of chip jointly developed with IBM and Toshiba that contained nine simultaneously-working microprocessors all within a half-inch square of space. The PS3 also included a Blu-ray Disc player, which represented another leap in technology due to its ability to store up to 50 gigabytes of high-definition content. The combination of the Cell and Blu-ray meant that Sony and third-party game designers could create both highly realistic and intricate games on a scale not previously achieved.

These advancements came at a steep cost, however. The development and production costs of the Cell and Blu-Ray caused Sony to price the PS3 for its November 2006 launch in the U.S. at $499 for the base model and $599 for an enhanced model with 40 gigabytes more of storage space. This price range was substantially higher than both Xbox 360 ($299-$399) and the Wii ($249), and even then it was reported that, at the time of its launch, Sony was losing several hundred dollars on every PS3 that it sold. In addition to its high retail price, the lack of many PS3 game titles available was an added reason why it was hypothesized that only the most diehard of gamers were purchasing the system. The end result was that some industry analysts were calling the launch of the PS3 “botched” and the largest maker of PS3 games, Electronic Arts, said it was “disappointed” at the ratio of PS3 games sold to each system purchased.

By the summer of 2007, Sony faced significant challenges in regaining a leadership position in the market for video game consoles. Jack Tretton, the new chief executive of Sony Computer Entertainment of America, acknowledged as much. “We have paid the price in the short term, hopefully for long-term success,” he said. The tone of his comments marked a departure from the confidence expressed by Hirai less than seven months before. If history was any guide, such caution was warranted. For since its inception, the video game industry had certainly served as a prime example of the old adage that past performance did not necessarily guarantee future success.

A Concise History of Video Games

The Genesis of Video Games

The origins of the modern video game industry can be traced back to the proliferation of pinball machines, jukeboxes, and other novelty games in the 1930s and 1940s, and to the technological advancements that would occur in subsequent decades. Early electromechanical games were mostly based on physical activities or pastimes such as baseball, horse racing, and automobile racing. Another popular theme involved the simulated shooting of electrically-powered rifles and pistols at light-sensitive targets. In one game called Six Gun, game players challenged a cowboy mannequin

---

3 Ibid.
6 Mike Snider “PlayStation 3 price cut by $100, System’s launch less successful than Sony hoped” USA Today, July 9, 2007.
carrying two pistols to a Western-style gunfight. Each draw against the mannequin cost a nickel. The coin-operated game industry was born.

From 1947 to 1970, the emergence of the first semiconductors, transistors, and integrated circuits (i.e., the microprocessor “chips” we know today) provided a breakthrough in the development of computers and other advanced electronics. Such technology in the beginning was only available to a limited number of universities and national laboratories, yet it didn’t take long for students and researchers of those institutions to develop the first video games. In 1958, William Higinbotham, a physicist at Brookhaven National Laboratory, developed what many consider to be the first video game, *Tennis for Two*, which was played using two controllers and an analog oscilloscope (*Exhibit 1*). In 1961, the first video game programmed on a computer, *Spacewar*, was principally developed by Steve Russell, a student at MIT. Neither *Tennis for Two* nor *Spacewar* were ever sold commercially.

The idea for playing video games on home television sets came in September 1966 from Ralph Baer, an engineer and division manager at Sanders Associates, a military contractor. His team developed a working prototype of a two-player tennis game with markedly different electronic components from those used by Higinbotham a decade before. Serving as a model design for decades to come, Baer’s game system utilized a standard television set as a display as well as a console, dubbed the “Brown Box”, and separate controllers for each player. A deal was reached with Magnavox to commercialize Baer’s invention, and in 1972 the first home video game console, the Odyssey, was launched with 16 pre-programmed games and a retail price of $99. The commercial response: total sales figures of the Odyssey during its production and sales period from mid-1972 to early 1975 were estimated to be as much as 360,000 units. Despite the modest sales by today’s standards, the Odyssey was generally viewed as a success in that it provided a glimpse of the commercial potential for video games. In 1972, another person realizing the commercial potential for video games was Nolan Bushnell, and later in the 1970’s, Bushnell and the company he helped to found, Atari, would become major winners in the burgeoning video game industry.

**Over the Years, Industry Winners and Losers**

While Ralph Baer may be known legitimately as the “Father of the Video Game,” Nolan Bushnell can lay claim to the title “Father of the Industry.”

— Excerpt from *High Score! The Illustrated History of Electronic Games*

Upon its founding in June 1972, the first video game created and manufactured by Atari was (none other than) a coin-operated two-player tennis game similar in concept to those previously developed by Higinbotham and Baer. *Pong*, as it was called, was an immediate success. In fact, the first *Pong* prototype placed in a local bar reportedly broke down because it became jammed with too many quarters. *Pong* also spawned a number of other similar ball-and-paddle games from

---

10 Kent, *The Ultimate History of Video Games*.
12 Demaria and Wilson, *High Score! The Illustrated History of Electronic Games*.
13 Some considered *Pong* to be a knock-off of previously-developed table tennis (i.e., ping-pong) video games.
competitor game companies. A race began to develop new game titles, and over the next several years, games such as Asteroid, Tank, Breakout, and Space Invaders became hits in video arcades.

By all accounts, the launch of the Atari Video Computer System (VCS) in October 1977 fundamentally altered the video game industry. Notably, it was the first console to come with two joysticks, could play games in color, and allowed players to select a level of difficulty before beginning a game. The VCS, which retailed at launch for $199, was also the first console to successfully use interchangeable cartridges to store games. The first VCS consoles shipped with a single game cartridge, Combat, and eight other game cartridges could be purchased for $30 apiece. According to former Atari executives, the profit margin of the VCS was kept low since they planned to recoup any hardware losses on the sale of game cartridges, which could be manufactured for less than $10.\textsuperscript{14} VCS had a simple design and straightforward instructions, and new owners of the VCS could begin playing video games without having to deal with any complex set-up issues.\textsuperscript{15}

By 1980, Atari controlled 75\% of the total video game market with annual sales of nearly $2 billion and was widely considered to be the dominant player of the video game industry. Atari chief executive Ray Kassar cogently described the company’s success: “one year we made $400 million after taxes. It was the most profitable company in the world.”\textsuperscript{16} Although Atari sold more than 30 million VCS game consoles, over time things began to unravel. Bushnell was forced out of the company in a management dispute, and then in 1980 the company lost much of its talented game designers to Activision, the first company to focus solely on the development of video game software. In what soon became an unfortunate trend for incumbents in successive generations of video game consoles, Atari could not retain its leadership position when the next batch of game consoles hit the market a couple of years later.

And so it went for much of the 1980s and early 1990s – winners of one generation of video game consoles routinely lost market leadership in the following generation to a competing company (\textit{Exhibit 2}). Yet despite the intense competition, the video game industry as a whole blossomed during this period, and video games became an integral form of worldwide entertainment. A series of video game hits, from Pac-Man to Donkey Kong to Mario Bros., were not only commercial successes for both arcades and video game consoles, but they also became household names. The topic of video games, for instance, made the cover of \textit{Time} magazine in 1982, and soon video games began to converge with other forms of entertainment. For example, movies such as \textit{E.T.}, \textit{Star Wars} and \textit{Star Trek} were adapted into video game franchises. Later on, the reverse occurred: video games such as \textit{Super Mario Brothers} and \textit{Lara Croft: Tomb Raider} were adapted for the big screen.

Market dominance for video game consoles over this period also shifted geographically from the west coast of the United States to Japan. Nintendo and Sega each launched market leading game systems during successive generations in the late 1980s and early 1990s. However, it was Sony and its PlayStation franchise that ultimately took over as market leader of video game consoles beginning in 1994. And during its time as market leader, Sony would achieve something that no maker of video game consoles had ever achieved before.

\begin{footnotes}
\footnote{Ibid.}
\footnote{The first personal computers from Tandy, Apple, and Commodore were also launched during this period and each had the capability to play video games. However, the first PCs were generally expensive, making them unaffordable for many consumers only interested in playing video games (e.g., the Apple II was \textdollar1300, not including a monitor and disk drive).}
\footnote{Kent, \textit{The Ultimate History of Video Games}.}
\end{footnotes}
The Ascent of Sony and PlayStation

More than a dozen years after its introduction in the U.S. on September 9, 1995 for a retail price of $299, the rise of Sony Computer Entertainment and the original PlayStation has been attributed to several key factors. First, leveraging its history as a hardware manufacturer with a long line of successful products such as the Walkman, Sony’s PlayStation console provided fast-paced, three-dimensional graphics which were visually superior to those of Nintendo and Sega at the time. Second, Sony was able to quickly establish license agreements with a large number of third-party game developers, some of which turned into exclusive arrangements. And third, Sony executed a well-coordinated launch campaign across multiple forms of media, including both television and print. Sony’s ascent to market leadership was fast. It sold three million consoles in just a few weeks, and ultimately sold more than 100 million PlayStation consoles worldwide.17

For the sixth generation of video game consoles in 2000, Sony appeared ready to take its blitzing approach for new product introductions to a whole new level. As with PlayStation, the PlayStation 2 (PS2) included a number of technological advances over the previous generation such as online connectivity and the inclusion of a DVD player. But unlike PlayStation, the PS2 was launched worldwide over the course of just nine months, a significant feat for Sony. Moreover, it was received by consumers with even greater fanfare than PlayStation before it. In Japan, for instance, Sony sold more than one million PS2 consoles in two days, a new sales record. PS2 was launched in the U.S. in October 2000 for a retail price of $299.18 In total, twenty million PS2 consoles were sold worldwide in its first 12 months on the market.19 Unlike any incumbent console in previous generations, Sony established itself as the market leader in two consecutive generations of video game consoles.

The sixth generation also brought new competition for Sony. Microsoft, arguably the most dominant software company in the world, entered the market for video game hardware in full force by launching its own game console, Xbox, in 2001. To many industry observers, this was the proverbial shot across the bow for Sony and its PlayStation franchise. In particular, it was believed that Microsoft could use its expertise in software development to win over third-party game developers while concurrently developing its own stable of successful game titles. This, combined with Microsoft’s deep financial resources and overall marketing muscle, quickly made Xbox into a formidable competitor, and it ultimately grabbed 24% of the market (Exhibit 3). Even though it was a distant second to PS2, which controlled almost 60% of the market, it was clear that Microsoft was in the business for the long haul. “We may still be losing money, but I bet we can take Sony next generation,” predicted Microsoft CEO Steve Ballmer in 2004.20

The Build-up to the Seventh Generation of Video Game Consoles

By early 2005, the sixth generation of video game consoles had begun its descent in terms of sales as anticipation for the next generation of game consoles began to build. Despite declining hardware sales, the good news was that demand for videogame software was stronger than ever (up 7% to $6.2 billion in the U.S. or 248 million units sold). And the good news was only expected to get better.

---

17 Winnie Forster, The Encyclopedia of Game Machines: Consoles, handhelds, & home computers.
19 Winnie Forster, The Encyclopedia of Game Machines: Consoles, handhelds, & home computers.
Worldwide sales of video game titles in 2004 were $24.5 billion and were projected to shoot up to $55 billion by 2008.21 The average game user was now twenty-four years old, having grown-up with video games as a child and teenager and now with the disposable income of a full-time job.22 Besides increasing the number of older game players, video games were also drawing kids as young as 7 or 8 years old away from traditional toys like Barbie and G.I. Joe.

In addition to the changing demographics of video game players, the convergence in content between video games and movies that began in the 1980s had now reached new heights. In 2005, film studios and other traditional media companies began to get into the game (literally) by forming partnerships with video game development companies. For example, Paramount Pictures joined with Electronic Arts (EA) to develop a game in which the characters mimic the strategies of the Corleones, the mob family from the epic movie *The Godfather*. In addition, video games based on movies like *The Incredibles* were being used “to keep a story in consumers’ minds” until a movie sequel could be produced.23 The observed convergence in the content provided an opportunity for Sony, which owned both content and electronics businesses. Sony’s PS2 video game, *Spider-Man 2*, based on the company’s successful movie release, was among the top 10 game titles in 2004, selling more than 1.1 million units in the U.S. at an average retail price of $43 according to NPD Funworld.24

**Microsoft and Sony Take Different Strategic Paths**

...somehow, some way consumers in the future will probably need a device to organize all the digital fun streaming around their lives. Sony believes the superbox will sneak into the living room in the guise of a non-threatening consumer appliance...For the next iteration of its star game [PlayStation] platform, Sony is spending $1.67 billion to develop a “cell” chip capable of teraflop speeds. In one swoop, Sony will place a supercomputer in an innocent-looking piece of entertainment hardware and drop it into the home, leading couch potatoes painlessly to their digital nirvana.

— Holman Jenkins, *The Wall Street Journal*25

Executives from Microsoft, Sony, and Nintendo had long been hesitant to provide details on their seventh generation consoles for fear of undercutting sales of the current generation. Nevertheless, in early 2005, details of the approaches taken by two of these companies – Microsoft and Sony – began to emerge and were reflective of the historic expertise of each company. Microsoft’s strategy focused on the game development process through the creation of XNA, a new set of software tools that could be used to write games for the PC, Xbox, and the next generation Xbox. The thought behind these tools was to provide a faster and less expensive way for game creators to build games for the Xbox franchise. With development costs for a single game expected to be as high as $20 million, up from about $3 million five years before, the tools were intended to attract game development talent to the Xbox platform.26

For PS3, Sony was focusing on the development of its revolutionary hardware platform of the Cell chip and Blu-ray Disc player. The Cell chip was designed to act as a system of processors; one

---


primary Cell chip could either perform particular operations or delegate them to another Cell chip. By distributing the processing efforts so efficiently, several Cell chips put together were capable of running at 256 gigaflops, or about 10 times the speed of the fastest PCs. The other key component of Sony’s strategy – its proprietary Blu-ray Disc player – provided a novel way to store high-definition digital content, including movies as well as video games. By developing Blu-ray on its own, Sony was competing to become the new standard format for next generation DVDs. Another company, Toshiba (Sony’s partner in developing the Cell), was the principal developer of an alternative high-definition disc format called HD-DVD. The decision to include both the Cell and Blu-ray Disc player in PS3 appeared to be lengthening its overall development time. By mid-2005, only Microsoft had committed to delivering its next generation console in time for the 2005 holiday season. In addition, taking advantage of the Cell and Blu-ray required a major change in the way video game software was written, potentially adding to the approximately 18-month lead time necessary for game developers to create video games for a new console platform.

It wasn’t clear in mid-2005 what effect the 18-month lead time would have on the delivery date of the PS3 or whether being first to market would even matter at all in the seventh generation. The same could be said for Sony’s push to converge several different hardware devices into a single device for the living room. At this point, one could only say that Microsoft and Sony appeared to be on very different strategic paths.

The Seventh Generation Finally Arrives

This Time, Microsoft Makes It First to Market

In November 2005, one could tell by reading the nation’s newspapers that something big was about to happen in the world of video games. In keeping with a popular theme in video games themselves, there was no shortage of news articles referring to imminent warfare, battle, or combat when the subject of the seventh generation of video game consoles was mentioned. The first sentence of one article began: “the video game business is powering up for its biggest battle in five years”.

Since the previous generation was essentially a lop-sided victory for Sony, some industry observers might have dismissed the build-up by the press as all-too-typical overstatements intended to sell newspapers. However, on November 22, Microsoft launched its next generation console, Xbox 360, to mostly positive reviews and became a prized item of the 2005 holiday shopping season. Moreover, Sony and Nintendo were not expected to launch new consoles until the spring of 2006 at the earliest. It was no doubt a big opportunity for Microsoft to gain a sizable lead over its competitors.

Even though the Cell had so far received more attention for its computing prowess, the new Xbox 360 was no slouch itself, and was much faster than the original Xbox. In his review, Walter Mossberg of The Wall Street Journal described Xbox 360’s graphics as “fluid” and “movielike”, calling the console “an outstanding game machine”. But the system went well beyond just gaming, as noted by Mossberg:

[L]ike earlier game consoles, it can play CDs and DVDs. Like the original Xbox, the new model can connect to the Internet to allow multiplayer gaming with people all over the world. But it also can play music, video clips and photos from its own hard disk or from the


hard disk of another computer over a network, or stream music from an Apple iPod plugged into one of its ports.29

Xbox 360 was not without a few drawbacks. Namely, two versions of the Xbox 360 were available at launch – a “Core System”, which retailed for $299, and a $399 version that came with a detachable 20 GB hard drive. The catch: only the more expensive version could play games from the previous Xbox since it required software found only on the detachable hard drive. The $399 price tag of the enhanced Xbox 360 also made it about twice as expensive as existing Xbox consoles and PS2s.

As for the Xbox 360 games, in addition to launching new video game titles for the platform, Microsoft continued the development of its online gaming service, Xbox Live. As with the original Xbox, in order to play online, users needed to open an Xbox Live account. Both the $299 and $399 versions of Xbox 360 came with a free “Silver” membership, which enabled users to send and receive voice and text messages as well as to download free game demos. In order to play games online against other players, a “Gold” membership was required, which cost a subscription fee of about $50 per year.30 The appeal of a Gold membership was that subscribers could quickly find others to play, whether friends or strangers, without having to gather in the same physical location. For the launch of Xbox 360, Microsoft had developed an enhanced matchmaking process in order to efficiently pair players from around the world with similar game scores and abilities.31

The financial investment made by Microsoft into Xbox Live and Xbox 360 had been substantial by all accounts. In 2002, Microsoft itself had publicly committed to invest $2 billion over five years on its video game business overall.32 By November 2006, a year after its debut, these investments by Microsoft appeared to be paying off. Xbox 360 was off to a strong start in making good on CEO Steve Ballmer’s prediction two years earlier to outsell Sony in the seventh generation of video game consoles. According to the website VG Chartz, almost six million Xbox 360s were sold worldwide during its first year on the market; an estimated 3.75 million of this total had been sold in the United States.33 An added benefit for Microsoft was that the launches of Nintendo’s and Sony’s next generation console platforms had been delayed several times during 2006 and were now both slated for the month of November, giving Microsoft a full year’s head start on the competition. Nevertheless, Xbox 360 was about to encounter its first real test in the marketplace.

Sony Makes a Splash; Nintendo Steals the Show

Just over a year after writing his review of Xbox 360, Walter Mossberg was back on the subject of new video game consoles in late November 2006, this time with a dual-review of the “long-anticipated” PS3 from Sony and the “more obscure” Wii from Nintendo.34 In his review, the differences between the Wii and PS3 were immediately apparent to Mossberg. “These two new game machines couldn’t be more different,” he said. In describing the characteristics of each console, Mossberg called the PS3 a “bulky, shiny black box” that included a host of features: a hard disk, a

29 Ibid.
31 Misha Davenport and Lucio Guerrero “Xbox 360: It's fast, it's sleek, it's pricey: Vying for video-game dominance, Microsoft takes one giant leap” The Chicago Sun-Times, Nov 15, 2005.
networking port, Wi-Fi wireless networking, and playback of CDs, DVDs and high-definition Blu-ray Discs (see Exhibit 4 for a side-by-side comparison of the seventh generation consoles). In contrast to the PS3, Mossberg described the Wii as a “small, thin white box” with “much wimpier specs”. Although it included Wi-Fi, the Wii did not come with a hard disk, a networking port, or the ability to play CDs or DVDs. Additionally, unlike the PS3, the Wii could not play high-definition video content.

To test the two consoles, Mossberg and his coauthor, Katherine Boehret, enlisted the help of four experienced video game players, three men and one woman, all of whom were in their 20’s. Each tester played a half-dozen or so games on each console. Their reaction to playing the two consoles appeared to surprise even themselves, and Mossberg captured these initial thoughts in his review:

[In] our tests, we found the more modest Wii to be the more exciting, fun and satisfying of the two new game machines. We and our four volunteer testers were impressed by the rich, realistic graphics and intricate game play in some of the half-dozen PS3 games we tried. By contrast, we all agreed that the graphics on the Wii ranged from dated to cheesy. But the Wii won our hearts for one reason: it uses a wireless controller that can detect your arm and hand motions and transfer them to the screen, so that you can physically control the action. This opens up huge possibilities. In sports games, you can actually swing a baseball bat or tennis racket or golf club. In adventure games, you can slash a sword through the air or throw a punch. You make pretty much the same motions using your full arm and hand that you’d make with the real objects.

Then, in a severe blow to Sony, Mossberg summarized the conclusions of the testers by writing that “none of us felt that the game graphics, or the Blu-ray movie playback, were superior enough to the Xbox 360’s graphics and DVD playback to justify the PS3’s heftier price” and none of the four testers said that they would purchase the PS3 at $599. Mossberg’s review may have been the ultimate harbinger of things to come for both Sony and Nintendo. Sales of the Wii accelerated during the 2006 holiday shopping season and continued throughout the first quarter of 2007. By the end of March 2007, ~2.32 million Wii’s had been sold in the United States, resulting in nearly a 25% market share for Nintendo (Exhibit 5). Over the same time period, only ~1.28 million PS3’s were sold, resulting in just a 13.5% market share for Sony.

As word of mouth spread, the Wii began to attract greater and greater attention of both the news media and consumers. In particular, the most notable aspect of the Wii’s success seemed to be that it attracted a very different group of consumers than those of previous generations of game consoles. An emerging segment of game players called “casual game players” was purchasing the Wii in large numbers; this segment included younger kids between five and nine years old as well as older adults in their 40’s, 50’s and 60’s. The Wii’s wireless controller and its straightforward-yet-physically-challenging games such as Wii Sports even attracted elderly game players in nursing homes. In one story on National Public Radio’s All Things Considered, Esther McGuire, 84, a resident of a senior living community in Silver Spring, Maryland, organized Wii bowling tournaments with her fellow residents. “It feels good,” she said. “It keeps us moving instead of watching television.” Another story was reported in the June 7, 2007, issue of The New England Journal of Medicine. Dr. Julio Bonis diagnosed himself with a new kind of acute tendonitis which he called “Wiiitis”. The cause of the injury was playing hours of tennis on his new Nintendo Wii console.

35 The $499 model of the PS3 was also deemed to be a poor choice since it lacked Wi-Fi capabilities.
The success of the Wii continued, and over the course of 2007, it further eroded the market share leadership of the Xbox 360 (Exhibit 5). Sony’s sales woes continued into the summer months, a time when the strain from PS3’s lack of success started to show itself clearly to the public. On June 18, 2007, two days after Father’s Day in the United States, Ken Kutaragi, himself known as the “Father of the PlayStation franchise”, stepped down as the head of Sony’s gaming division, Sony Computer Entertainment. Perhaps more than any other figure within Sony, the PS3 was seen as Kutaragi’s “brainchild”. In a separate incident, after an uproar in the United Kingdom about a PS3 game that featured a graphic shootout inside an Anglican cathedral, Sony was forced to make a public apology to the Church of England. Adding to the bad news, in contrast to the healthy $75 million profit that Sony reported for its games division in the fiscal year ending March 31, 2006, Sony also admitted publicly that it was not expecting to post a profit again in its game business until fiscal year 2009.38

Although the high retail price of the PS3 was often cited as the primary reason for its slow sales, higher retail costs of individual game titles ($59.99 for PS3 vs. $19.99-$49.99 for Wii vs. $19.99-$59.99 for Xbox 360) as well as an overall dearth of PS3 game titles available were other major drawbacks of the PS3.39 While it was generally less expensive to develop game titles for the Wii platform, costs could exceed $20 million for a single game title on the PS3 or Xbox 360 platforms. Even if the retail price for a game title was increased to $60, however, it wasn’t clear how soon a game publisher could recoup its investment and turn a profit (Exhibit 6).40 This made developing new game titles, particularly for the PS3 since it was an entirely new hardware platform, a potentially risky proposition. Not surprisingly then, it was reported that 86 new games were to be released for the Wii during the fourth quarter of 2007, as compared to 47 for the Xbox 360 and 38 for the PS3.41

In October 2007, at long last to some industry observers, Sony finally took action on the PS3’s high retail price by reducing that of the 80GB model from $599 to $499. Sony also introduced a new $399 40GB model on November 2, 2007.42 In its announcement, Sony cited a reduction in manufacturing costs as a primary reason for its ability to cut PS3’s price. Although the current PS3 manufacturing cost was not publicly known, estimates for its cost at launch were as high as $800 (Exhibit 7). Separate from the announcement about PS3’s new retail price, in an effort to kick-start development efforts by third party game producers, Sony also reduced the fees it charged for the PS3 development kit, the software tools needed to create new PS3 game titles. Both of these actions provided a much needed boost for Sony. Weekly PS3 sales reached more than 100,000 consoles following the price reduction as compared to an average of 30,000 to 40,000 before the price cut.43 Unfortunately for Sony, the PS3 wasn’t the only one getting a boost in the fall of 2007.

Microsoft Gets a Boost

Lest its presence on the market be forgotten among the fervor over the Wii and news reports of Sony’s price cut, on September 25, 2007, Microsoft received a tremendous boost from the launch of Halo 3, the third installment of a science fiction game set in the year 2552. Developed exclusively for

39 Price ranges of game titles for each platform was estimated by browsing online retailers such as Best Buy and Circuit City.
42 Ryan Kim “Sony fixing PlayStation 3 just in time; Lower prices, new games resurrect video console for holiday season” The San Francisco Chronicle, Nov. 19, 2007.
43 Ibid.
the Xbox 360 platform by Bungie Software, a wholly-owned subsidiary of Microsoft, the *Halo* franchise had proven in previous years to be unlike any other video game title due to its detailed, multi-layered backstory about a hero, Master Chief, and his fight against evil forces. Worldwide sales of Microsoft’s *Halo* and *Halo 2* for the original Xbox, for instance, were more than $600 million, compared with about $460 million in global box-office sales for the blockbuster movie *Gladiator*.44

The launch of *Halo 3* lived up to the media hype over its release. Within 12 days, it had sold 3.3 million copies, according to NPD. Sales figures also showed that *Halo 3* had outsold the next best-selling game, *Wii Play*, by more than 10-fold. David Dennis, a Microsoft spokesman, reported with pride that *Halo 3* had sold more copies than all PS3 games for the months of May, June, July, August and September … combined. The success of *Halo 3* at least temporarily spurred sales of Xbox 360 past the Wii (Exhibit 8). During the sales period that ended on October 6, Microsoft sold 528,000 Xbox 360s, compared with about 500,000 Wiis and 119,000 PS3s.45 *Halo 3*’s launch was even cited as a primary reason for the failure of the latest Ben Stiller movie, *The Heartbreak Kid*, which opened at the box office on the same weekend.46

Another Xbox 360 milestone was reached in early November, this time in Japan. Although in its home country Sony had retained market leadership over Xbox 360 since the launch of the PS3, for the first time, weekly sales of Xbox 360 in Japan surpassed those of PS3.47

**Observations from the 2007 Holiday Shopping Season**

With the re-emergence of Xbox 360 due to the success of *Halo 3* and the much-needed price reduction of the PS3, it was anticipated that the 2007 holiday shopping season would be an all-out war between the three seventh-generation video game consoles. When the dust settled in early January 2008, the following observations could be made:

- Reports of long lines and short supplies of the Wii at retail stores persisted throughout the holiday shopping season, more than a year after its launch.48 Some industry analysts went so far as to claim that short supplies of the Wii were an intentional strategy by Nintendo to keep the market buzz for its console at a fever pitch.49

- Although it wasn’t able to significantly close the weekly sales gap between the PS3 and its competitors during the holiday shopping season, Sony continued to benefit from strong sales of the PS2, which could still be purchased in stores and online from retailers such as Best Buy and Amazon for about $130.50 Yearly sales of the PS2 in 2007 exceeded 4 million units in the U.S., and if lumped in with the seventh generation consoles, the PS2’s market share was 21.7% in the U.S. and more than 22% worldwide (Exhibit 9).

• Xbox 360 enjoyed the strongest software-to-hardware attach rate of seventh generation consoles (defined as the total number of game titles purchased over the life of the console). In September, the trade journal Warren’s Consumer Electronics Daily reported an attach rate of 6.3 games per console for Xbox 360, as compared to 3.5 for PS3 and 3.4 for Wii.\(^{51}\) By the end of the holiday season, the attach rate for Xbox 360 had grown to 6.9 while the attach rate for the other consoles had remained constant.\(^{52}\)

Winning the High-Definition Format War

*The biggest consumer electronic format war in a generation is officially over.*


The competition between Toshiba (HD-DVD) and Sony (Blu-ray) to become the *de facto* standard format for high-definition content was reminiscent of a nearly identical competition between Toshiba/Panasonic (VHS) and Sony (Betamax) in the 1980s to become the standard format for recordable video tape cassettes. It was reminiscent, that is, with one notable exception: Sony ultimately lost the format war between VHS and Betamax, but by most accounts it appeared to have won the format war this time around. As was the case with VHS and Betamax, the deciding factor in ultimately determining the winning high-definition format seemed to come down to the decision of major motion picture studios to align with one format over the other.

To that end, in early January 2008, it was widely reported that Warner Brothers, the nation’s largest movie studio, had decided to use the Blu-ray format for its future high-definition DVD movie releases. With Warner Brothers on board, Blu-ray was now the standard of choice for about 70% of the market, and its decision to go with Blu-ray appeared to be the tipping point of the format war. “The overwhelming industry opinion is that this decides the format battle in favor of Blu-ray,” said Richard Doherty, an industry analyst.\(^{54}\) Then in February 2008, a group of influential movie retailers – including Wal-Mart, Best Buy, and the online video rental company Netflix – all backed Blu-ray. It was at this point when Toshiba appeared to throw in the towel by announcing that it would no longer produce or market HD-DVD players.

Becoming the standard format for high-definition content had higher stakes than one might initially realize because of the significant royalties that could be earned by either Sony or Toshiba in licensing the technology to other companies. For example, in addition to royalty amounts earned on each disc/title sold using the current DVD format, manufacturers paid between $10 and $20 for every dedicated movie player, computer, or game console that incorporated the technology.\(^{55}\) For high-definition DVDs, some analysts estimated that the winner of the format war would earn $2 billion  

---

annually in royalties.\textsuperscript{56} As a result, with Toshiba’s surrender, Sony stood to gain substantially for many years to come, or at least until other forms of high-definition storage were commercially viable. Sony had also won in another way. Up to this point, Microsoft had sided with Toshiba in the high-definition DVD format war by offering a detachable HD-DVD drive as an option for Xbox 360, and the Wii offered no high-definition graphical capabilities at all. To the extent that Microsoft or Nintendo sought to offer high-definition video game titles for each platform in the near-future, for now Blu-ray seemed to be the only option.

\textbf{Sony Hopes for a Better 2008}

Sony executives could only hope that the New Year would bring better days for its video games division. Although no one in their position would be expected (or permitted) to take the situation lying down, it was unclear exactly what Sony should do at this point in the seventh generation of video game consoles. The success of Nintendo’s Wii more than a year after its launch raised a number of difficult questions for Sony to consider. Most importantly, had Nintendo fundamentally altered the market for video games by successfully targeting previously untapped demographics, or would this success be fleeting and the Wii be just another fad that would eventually burn out? Put another way, Sony needed to determine if Nintendo had achieved a game-changing event similar, for example, to that achieved by Apple with the iPod. If the market for video game consoles was truly undergoing a permanent expansion, then Sony needed to consider whether to focus on developing devices and games for a broader audience of game players or to keep its focus on the segment of devoted hard-core gamers. Depending on the answers to these questions, Sony’s strategic direction in 2008 and beyond could take on many different forms.

There was also another line of questions to consider. Rather than representing a major tectonic shift in the market demographics for video game consoles, the Wii might owe its success to a few simple reasons which, if addressed quickly, could help to turn things around for Sony. First, if the Wii’s success was due primarily to the popularity of its motion-sensing wireless controller, then Sony could look to quickly develop a similar one of its own that was more advanced than the current PS3 controller, which had limited motion sensing abilities. Since the PS3 was generally judged to be technologically superior to the Wii in virtually every other way, then filling this competitive gap might provide Sony with just the market edge that it needed. Nevertheless, given the substantial investments that Sony had already made into Blu-ray and the Cell microprocessor, such a decision would undoubtedly be a difficult one and could further postpone the profitability of the PS3.

A second reason for PS3’s stagnant sales might be described in a single word: price. As of the end of 2007, the $399 and $499 versions of the PS3 were still substantially more expensive than both the Wii ($249) and Xbox 360 (now $279-$349)\textsuperscript{57}. As a result, someone interested in purchasing a PS3 and a couple of game titles could quickly spend $600 or even $700, while a similar Wii customer need only spend half as much. Perhaps a lower price point was the key to the whole equation, and as soon as the PS3 could achieve manufacturing volumes sufficient enough such that Sony could afford to charge less, then PS3 adoption would rapidly accelerate. However, even if this was indeed the root cause of the problem, there was still the question of what promotional programs Sony should put in place in order to spur short-term sales of the PS3. For its part, in late 2007, Sony announced two such

\begin{flushright}
\textsuperscript{56} Ryan Kim “Keeping players in the game / Re-energizing the game industry: E3 trade show takes on added significance with the introduction of next generation of video game consoles and a looming DVD format battle” \textit{The San Francisco Chronicle}, May 8, 2006.
\end{flushright}

\begin{flushright}
\textsuperscript{57} As of March 2008, Microsoft also offered a $449 Xbox 360 “Elite” console that came with a 120 GB detachable hard drive for storing saved games, movies, music, and other content.
\end{flushright}
promotional programs. The first program gave away five free Blu-ray movies via a mail-in offer with the purchase of every new PS3. The second program offered a free PS3 ($499 80GB model) with the purchase of a Sony high-definition television (HDTV). Assuming that lowering the price of the PS3 any further would have to wait until at least the fall of 2008 (as component costs came further down), what other promotional programs could Sony implement right now to boost lagging PS3 sales?

As a silver lining to Sony’s predicament, there was at least one unexpected event during the last two months of 2007 that appeared to be benefiting not only Sony but the video game industry as a whole. Since game publishers generally relied on nonunion talent to create video games, the Writers Guild of America strike, which had now entered its eighth week, appeared to be boosting video game sales. According to NPD, sales of consoles, games and accessories hit $2.63 billion in November, up 52% from the previous year. Sales of games alone had increased 62% to $1.3 billion in November. Still, even then, Nintendo seemed to be stealing attention away from Sony and PS3. The caption in one article by The Associated Press said it all: “people may pick up their Wii remote instead of their TV remote if the Hollywood writers strike drags on into 2008.”

On numerous occasions over the course of the year, 2007 had been referred to as “The Year of the Wii”. Whether 2008 would be triumphantly called “The Return of the PS3” or disappointingly called “Sony PS3: Game Over” was still undetermined, but it was clearly a game in which Sony was now playing from behind.

---
58 For a period of time, Microsoft offered a similar promotional program with Xbox 360. With the purchase an Xbox 360 HD DVD player, which retailed for about $180, a customer received five free HD DVD movies via mail-in offer and a copy of King Kong was included inside the box with purchase.
59 http://sonycard.sony.com/sonygateway (accessed December 29, 2007). This offer was valid only for Sony Card holders from November 1, 2007 to March 31, 2008 on Sony HDTVs with a minimum retail price of about $2,500.
Exhibit 1  Video Game Console Milestones

*Tennis for Two*, developed by William Higinbotham, on display at Brookhaven National Laboratory in 1958 (*right*); the game was displayed on an oscilloscope (*left*).

*Odyssey*, developed by Ralph Baer, was the first video game console marketed in the U.S.

Sources: Photos of *Tennis for Two* obtained from Brookhaven National Laboratory (www.bnl.gov/bnlweb/history/higinbotham.asp, accessed October 29, 2007), reprinted with permission. Photos of *Odyssey* obtained from Ralph Baer (reprinted with permission).
**Exhibit 1 (cont.)** Video Game Console Milestones

The Atari VCS console (*shown above*) and its successor, the Atari 2600, were the first blockbuster video game consoles, selling more than 30 million units collectively worldwide.

The Sony PlayStation2 was the undisputed winner of the sixth generation of video game consoles, selling more than 118 million consoles worldwide (as of October 21, 2007).

Sources: Photos of the Atari VCS obtained from AtariAge (www.atariage.com/2600/systems/sys_AtariVCS.jpg, accessed November 4, 2007, reprinted with permission. Photos of PlayStation2 obtained from thegameconsole.com (reprinted with permission).
Exhibit 2  Timeline of Various Generations of Video Game Consoles (market leaders of previous generations in **bold**)

- **Late 1970s**  
  Atari (2600)

- **Early 1980s**  
  **Coleco** (Colecovision)  
  Atari (5200)  
  Mattel (Intellivision)

- **Mid-Late 1980s**  
  **Nintendo** (NES)  
  Atari (7800)  
  Sega (Master)

- **Early 1990s**  
  **Sega** (Genesis)  
  Nintendo (SNES)  
  Philips (CDI)

- **Mid-Late 1990s**  
  **Sony** (Playstation)  
  Atari (Jaguar)  
  Nintendo (N64)  
  Sega (Saturn)

- **1999-Early 2000s**  
  **Sony** (Playstation2)  
  Microsoft (Xbox)  
  Nintendo (GameCube)  
  Sega (Dreamcast)

- **Mid-Late 2000s**  
  Sony (Playstation3)  
  Microsoft (Xbox 360)  
  Nintendo (Wii)

Source:  Case writer.
Exhibit 3  U.S. (top) and Worldwide (bottom) Cumulative Market Share of Sixth Generation Game Consoles (through December 31, 2005)

U.S.

```plaintext
<table>
<thead>
<tr>
<th>Game Console</th>
<th>U.S. Sales</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>GameCube</td>
<td>11.7M</td>
<td>18.2%</td>
</tr>
<tr>
<td>Xbox</td>
<td>15.5M</td>
<td>24.0%</td>
</tr>
<tr>
<td>PS2</td>
<td>37.2M</td>
<td>57.8%</td>
</tr>
</tbody>
</table>
```

Worldwide

```plaintext
<table>
<thead>
<tr>
<th>Game Console</th>
<th>Worldwide Sales</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>GameCube</td>
<td>20.3M</td>
<td>14.7%</td>
</tr>
<tr>
<td>Xbox</td>
<td>23.5M</td>
<td>17.0%</td>
</tr>
<tr>
<td>PS2</td>
<td>94.4M</td>
<td>68.3%</td>
</tr>
</tbody>
</table>
```

Source: Compiled from VG Chartz (www.vgchartz.com, accessed March 1, 2008).
Exhibit 4  Summary Schematics of Seventh Generation Video Game Consoles

**Console: Microsoft Xbox 360**

*Launch Date (in U.S.):* November 2005  
*Retail Price at Launch: $299-$399*

*System Highlights:* $299 version comes without a hard disk necessary for backward compatibility; $399 version also comes with a wireless controller, a headset; a remote control for playing media. DVD included at product launch; HD-DVD attachment is available for an additional $200; capable of Wi-Fi wireless networking.

*Notable Game Titles at Launch:* Crackdown (Microsoft), Gears of War (Microsoft), Major League Baseball 2K7 (Take 2 Interactive)

**Console: Sony PlayStation 3**

*Launch Date: November 2006*

*Retail Price at Launch: $499-$599*

*Key Features:* Includes a hard disk, Cell chip technology, Wi-Fi wireless networking (not available on $499 version), plays DVDs and CDs, produces high-definition video, plays next-generation, high-definition movie disks called Blu-ray. Wireless controllers have limited motion-sensing capabilities.

*Notable Game Titles at Launch:* Resistance: Fall of Man (Sony), Virtua Fighter 5 (Sega)
**Exhibit 4 (cont.) Summary Schematics of Seventh Generation Video Game Consoles**

**Console: Nintendo Wii**

**Launch Date:** November 2006  
**Retail Price at Launch:** $249

**Key Features:** Wi-Fi wireless networking, but lacks a hard disk, a networking port, and the ability to play DVDs or CDs; cannot produce high-definition video; fewer ports and connectors than either Xbox 360 or PS3. The key feature of the Wii is the wireless controller (approx. size of a TV remote control), which can detect arm and hand motions and transfer them to the screen. The controller also has a small built-in speaker and it transmits vibrations to make play more realistic.

**Notable Game Titles at Launch:** *The Legend of Zelda: Twilight Princess* (Nintendo), *Wii Sports* (Nintendo)

Exhibit 5  U.S. (left) and Worldwide (right) Cumulative Market Share of 7th Generation Consoles in 2007 (total shipments at the end of each calendar quarter)

**Week ending April 1, 2007**

<table>
<thead>
<tr>
<th></th>
<th>U.S.</th>
<th>Worldwide</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Wii</td>
<td>Wii</td>
</tr>
<tr>
<td></td>
<td>2.32M (24.5%)</td>
<td>5.77M (32.2%)</td>
</tr>
<tr>
<td></td>
<td>PS3</td>
<td>PS3</td>
</tr>
<tr>
<td></td>
<td>1.28M (13.5%)</td>
<td>2.8M (15.6%)</td>
</tr>
<tr>
<td></td>
<td>Xbox 360</td>
<td>Xbox 360</td>
</tr>
<tr>
<td></td>
<td>5.86M (61.9%)</td>
<td>9.35M (52.1%)</td>
</tr>
<tr>
<td></td>
<td>Wii</td>
<td>Wii</td>
</tr>
<tr>
<td></td>
<td>3.70M (31.3%)</td>
<td>8.9M (38.7%)</td>
</tr>
<tr>
<td></td>
<td>PS3</td>
<td>PS3</td>
</tr>
<tr>
<td></td>
<td>1.59M (13.4%)</td>
<td>3.75M (16.2%)</td>
</tr>
<tr>
<td></td>
<td>Xbox 360</td>
<td>Xbox 360</td>
</tr>
<tr>
<td></td>
<td>6.53M (55.2%)</td>
<td>10.4M (45.1%)</td>
</tr>
</tbody>
</table>

**Week ending July 1, 2007**

<table>
<thead>
<tr>
<th></th>
<th>U.S.</th>
<th>Worldwide</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Wii</td>
<td>Wii</td>
</tr>
<tr>
<td></td>
<td>2.32M (24.5%)</td>
<td>5.77M (32.2%)</td>
</tr>
<tr>
<td></td>
<td>PS3</td>
<td>PS3</td>
</tr>
<tr>
<td></td>
<td>1.28M (13.5%)</td>
<td>2.8M (15.6%)</td>
</tr>
<tr>
<td></td>
<td>Xbox 360</td>
<td>Xbox 360</td>
</tr>
<tr>
<td></td>
<td>5.86M (61.9%)</td>
<td>9.35M (52.1%)</td>
</tr>
<tr>
<td></td>
<td>Wii</td>
<td>Wii</td>
</tr>
<tr>
<td></td>
<td>3.70M (31.3%)</td>
<td>8.9M (38.7%)</td>
</tr>
<tr>
<td></td>
<td>PS3</td>
<td>PS3</td>
</tr>
<tr>
<td></td>
<td>1.59M (13.4%)</td>
<td>3.75M (16.2%)</td>
</tr>
<tr>
<td></td>
<td>Xbox 360</td>
<td>Xbox 360</td>
</tr>
<tr>
<td></td>
<td>6.53M (55.2%)</td>
<td>10.4M (45.1%)</td>
</tr>
</tbody>
</table>
**Exhibit 5 (cont.)** U.S. (left) and Worldwide (right) Cumulative Market Share of 7th Generation Consoles in 2007 (total shipments at the end of each calendar quarter)

**Week ending 9/30/07**

**U.S.**
- **Wii:** 5.25M (35.2%)
- **Xbox 360:** 7.57M (50.8%)
- **PS3:** 2.08M (14.0%)

**Worldwide**
- **Wii:** 12.26M (42.1%)
- **Xbox 360:** 11.98M (41.1%)
- **PS3:** 4.92M (16.9%)

**Week ending 12/30/07**

**U.S.**
- **Wii:** 8.48M (38.0%)
- **Xbox 360:** 10.34M (46.4%)
- **PS3:** 3.49M (15.6%)

**Worldwide**
- **Wii:** 19.1M (43.5%)
- **Xbox 360:** 16.1M (36.6%)
- **PS3:** 8.8M (20.0%)

Exhibit 6  Breakdown in Costs of a $60 Seventh Generation Game Title

Exhibit 7  Estimated Manufacturing Costs of PS3 Components at Launch and after Three Years

Note: Retail margin is typically 25%.

Source: Compiled from case writer estimates and Paul Sweeting and George Chronis “PlayStation 3 delay possible” Video Business, Feb 27, 2006.
Exhibit 8  Weekly U.S. Shipments of Seventh Generation Hardware (November 1, 2007 through December 30, 2007)

Exhibit 9  U.S. (top) and Worldwide (bottom) Market Share of Sixth and Seventh Generation Game Consoles in 2007 (measured in total annual shipments)\textsuperscript{61}

\begin{figure}[h]
\centering
\includegraphics[width=0.7\textwidth]{chart}
\caption{U.S. and Worldwide Market Share of Sixth and Seventh Generation Game Consoles in 2007 (measured in total annual shipments).}
\end{figure}


\textsuperscript{61} Note that Microsoft stopped selling Xbox shortly after introducing Xbox 360. Additionally, data are not measured as cumulative shipments (as in other pie chart exhibits) and represent annual shipments for 2007.